

Message Text

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FM AMEMBASSY PARIS

TO DEPARTMENT OF TREASURY

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AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY LONDON

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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 24285

USEEC

LIMDIS GREENBACK

E. O. 11652: GDS

TAGS: EFIN

SUBJECT: EMS -- STAFF STUDIES AND CONCEPTIONS

REF: (A) PARIS 23646, (B) PARIS 22190,
(C) BRUSSELS 14452

SUMMARY:

THE IMPLICATIONS OF THE BREMEN ACCORD ARE BEING STUDIED
IN GREAT DETAIL DURING THE MONTH OF AUGUST AT THE STAFF
LEVEL. THE FRENCH STAFF BELIEVES THE EMS HAS TO BE
SUBSTANTIALLY MORE FLEXIBLE THAN THE SNAKE TO MEET U.K.,
ITALIAN, AND THEIR OWN REQUIREMENTS. THE MAIN ELEMENTS
OF THAT FLEXIBILITY WOULD BE LIMITING THE WEIGHT OF THE
DM IN THE ECU BASKET, SMALL, PERIODIC DEVALUATIONS FOR
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THE WEAKER MEMBERS, AND THE AVAILABILITY OF CREDIT.
FRANCE WAS NOT MOTIVATED BY THE FEAR OF A WEAK DOLLAR
TO JOIN EMS. WITHIN LIMITS A WEAK DOLLAR WAS HELPFUL
IN STABILIZING DOMESTIC COSTS. THE CREATION OF EMS IN
AND OF ITSELF MIGHT EITHER DEPRESS OR RAISE THE VALUE
OF THE DOLLAR.

1. TREASURY ATTACHE MET WITH BAQUIAST, ACTING HEAD OF THE EXTERNAL DIVISION OF THE TREASURY BUREAU ON AUGUST 1. IN PAINSTAKING FASHION, HE EXPLAINED THE PROCEDURES, SOME OF THE OPTIONS BEING STUDIED, AND FRENCH POINTS OF VIEW. THE DISCUSSION WAS MORE TECHNICAL AND LESS POLICY ORIENTED THAN EARLIER CONTACTS (SEE REFS A AND B), REFLECTING BOTH HIS PREOCCUPATIONS AND MORE DISTANT RELATIONSHIP TO POLICYMAKING IN THIS AREA.

2. PROCEDURE

BAQUIAST HEADS THE WORKING GROUP OF THE EEC MONETARY COMMITTEE WHICH HELD ITS FIRST MEETING IN BRUSSELS ON JULY 27 AND 28. A PARALLEL GROUP FROM THE CENTRAL BANK GOVERNORS COMMITTEE HAS BEEN ASSIGNED THE TASK OF LOOKING INTO EXCHANGE ASPECTS. IT IS MEETING IN BASLE THIS WEEK. HIS GROUP WILL HAVE TWO MORE MEETINGS THIS MONTH, AUGUST 11-12 AND AUGUST 31-SEPTEMBER 1. THE EEC ECONOMIC COMMITTEE CONVENES ON AUGUST 11. (ITS ROLE WAS NOT CLEAR.)

3. THE OBJECT OF THIS WORK WAS TO CONSIDER THE IMPLICATIONS OF THE BREMEN ACCORD--THE ANNEX SYSTEM AS IT KNOWN AMONG TECHNICIANS. THEY ARE NOT WORKING ON AMENDMENTS OR OTHER PROPOSALS AT THIS POINT.

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4. FLEXIBILITY COMPARED TO THE SNAKE

THE TREASURY ATTACHE ASKED WHAT ELEMENTS WOULD BE BUILT INTO THE SYSTEM WHICH WOULD LESSEN THE POSSIBILITY, AS COMPARED TO THE SNAKE, OF A COUNTRY BEING FORCED TO LEAVE THE SYSTEM BECAUSE OF EITHER SHORT-TERM SPECULATION ON ITS CURRENCY OR INABILITY TO ADJUST QUICKLY TO BALANCE-OF-PAYMENTS DISEQUILIBRIUM. IN REPLY, BAQUIAST STRESSED THAT THE FRENCH WERE CONCERNED THAT THERE BE MORE FLEXIBILITY THAN THE SNAKE BECAUSE THE ITALIANS, BRITISH, AND "EVEN THEMSELVES" WOULD NOT BE WILLING TO JOIN OTHERWISE. THE ELEMENTS OF FLEXIBILITY WERE: (A) THE USE AND NATURE OF THE ECU, (B) THE WIDTH OF MARGINS, AND (C) THE POSSIBILITY OF PARITY CHANGES. (COMMENT: THE AVAILABILITY OF CREDIT WOULD BE ANOTHER ESSENTIAL FACTOR (SEE PARA 9).)

5. BAQUIAST THOUGHT (IN CONTRAST TO CLAPPIER) THAT THERE WAS GENERAL AGREEMENT IN PRINCIPLE THAT EMS CURRENCIES WOULD BE DEFINED IN TERMS OF THE ECU AND MARGINS

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ESTABLISHED IN RELATION TO IT. FROM THE FRENCH POINT OF VIEW, THE PRESENT WEIGHTING OF THE ECU, ONE-THIRD DM, TWO-THIRDS OTHERS, WAS ACCEPTABLE. BUT ONE COULD PROJECT A SITUATION IN WHICH THE DM WOULD HAVE A MUCH LARGER PROPORTION. THE ECU WAS CALCULATED BY MULTIPLYING FIXED WEIGHTS (BASED ON GNP AND INTRA-EUROPEAN TRADE) BY MARKET QUOTATIONS OF EACH CURRENCY. IF THE DM WERE TO APPRECIATE FOR A LONG PERIOD VIS-A-VIS THE OTHER CURRENCIES, ITS PROPORTION OF ECU WOULD INCREASE VERY SUBSTANTIALLY. THIS POSSIBILITY WORRIED THE BRITISH AND ITALIANS. FRANCE CERTAINLY HAD NO DESIRE TO BE ATTACHED TO AN ECU THAT WAS THE EQUIVALENT OF THE DM. HE DID NOT BELIEVE THE FAILURE OF THE BRITISH TO PARTICIPATE WOULD CHANGE THE WEIGHTING SIGNIFICANTLY BECAUSE FRANCE'S SHARE WOULD GO UP. STERLING IS CURRENTLY 12 PERCENT OF THE ECU. (IN CONTRAST TO CLAPPIER (REF B), HE HAD NOT WRITTEN THE U.K. OFF.)
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6. BAQUIAST SAID NOTHING ABOUT MARGINS EXCEPT TO CONFIRM THAT THEY HAD ONLY ONE TIER IN MIND. IN PRESENTING VARIOUS HYPOTHETICAL EXCHANGE SCENARIOS, HE USED 1 PERCENT OR 2 PERCENT AS EXAMPLES.

7. PROVISION FOR DEVALUATION HAD TO BE ACCEPTED AS PART OF THE SYSTEM. THE ITALIANS COULD NOT BE ASKED TO SUBMIT TO A "STRAIGHT JACKET" WHICH WOULD FORBID THEM FROM DEVALUING VIS-A-VIS THE DM AS LONG AS THEY HAD ANNUAL RATES OF PRICE INCREASE OF 15 PERCENT AND GERMANY FAR LESS. BUT IT HAD TO BE IN RELATIVELY SMALL AMOUNTS, SOMETHING LIKE THE CRAWLING PEG, AS AN EXAMPLE, AND ONLY IN RESPONSE TO UNDERLYING TRENDS.

8. INTERVENTION BETWEEN MEMBERS OF THE EMS

IN PRINCIPLE, INTERVENTION WOULD BE IN A EUROPEAN CURRENCY. IT REMAINED TO BE WORKED OUT HOW INTERVENTION WOULD TAKE THE PLACE AND THE ROLE OF THE EUROPEAN FUND IN SETTLING THE DEBTS THAT MIGHT BE INCURRED IN THESE OPERATIONS. UNLIKE THE SNAKE, ONE CURRENCY MIGHT BE AT THE TOP OF ITS BAND IN RELATION TO THE ECU WHILE NO OTHER CURRENCIES WOULD BE AT THE BOTTOM, IT WAS NOT CLEAR IN ADVANCE, THEREFORE, WHICH CURRENCY WOULD BE USED IN ANY PARTICULAR SITUATION.

9. THE EUROPEAN FUND

HE ENVISAGED TWO ACCOUNTS IN THE EUROPEAN FUND. ONE WOULD BE CREATED BY DEPOSITS OF RESERVES AND THE OTHER BY DEPOSITS OF NATIONAL CURRENCY. ACCOUNT I WOULD BE USED AS A SETTLEMENT FUND, ACCOUNT II AS A SOURCE OF CONFIDENTIAL

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CREDIT; OR THEY COULD BOTH BE USED FOR CREDIT. DOLLARS COULD BE LENT, FOR EXAMPLE, FROM ACCOUNT I. THESE DECISIONS SIMPLY HAVE NOT BEEN MADE. NEITHER HAD IT BEEN DECIDED WHETHER GOLD WOULD BE TRANSFERRED TO THE EUROPEAN FUND OR SIMPLY BE USED AS PART OF THE BASE FOR CALCULATING THE AMOUNT OF THE TRANSFER--I.E., 20 PERCENT. THAT TECHNIQUE MIGHT GIVE FRANCE A PROBLEM SINCE SO MUCH OF HER RESERVES WERE IN GOLD. HE ESTIMATED EACH ACCOUNT TO BE WORTH 35 BILLION DOLLARS AT PRESENT RESERVE LEVELS AND USING THE "ANNEX" PROPOSAL OF 20 PERCENT. CREDIT WAS CLEARLY AN ESSENTIAL PART OF THE OPERATION OF THE SYSTEM WITHOUT WHICH THEY WOULD NOT CONSIDER IT. "THE GERMANS UNDERSTOOD THAT."

10. RELATION TO THE DOLLAR

BAQUIAST DID NOT SEE A CONCERN ABOUT THE VALUE OF THE DOLLAR AS BEING FRANCE'S MOTIVATION TO JOIN THE SYSTEM. IT FELT THAT ITS EUROPEAN TRADE, AN INCREASING PART OF THE WHOLE, WAS BEING HELD BACK BY CURRENCY INSTABILITY WITHIN EUROPE. HE CITED, FOR EXAMPLE, THE DISPUTES OVER THE RATES TO BE APPLIED IN CAP. GERMANY MIGHT LIKE TO SEE THE DOLLAR STRONGER, BUT THAT WAS NOT NECESSARILY IN FRANCE'S INTEREST UNLESS THE RATE FELL TO 4/1 OR 3.5/1. IN FACT, GIVEN THE EXISTENCE OF A STRONG DM, DOLLAR WEAKNESS MADE IT EASIER TO STABILIZE DOMESTIC COSTS--I.E., WITH IMPORTS OF POL AND RAW MATERIALS BILLED IN DOLLARS.

11. WHEN FRANCE WAS A MEMBER OF THE SNAKE, IT HAD WANTED TO FIX A DOLLAR RATE BECAUSE IT THOUGHT BY SO

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DOING IT WOULD AVOID A SITUATION WHERE IT WAS ALWAYS AT THE BOTTOM OF THE INTERVENTION BAND SELLING DOLLARS WHILE GERMANY WAS AT THE TOP BUYING THEM.

12. THE CREATION OF EMS IN AND OF ITSELF COULD EITHER RAISE OR DEPRESS THE VALUE OF THE DOLLAR. BY REQUIRING THE DM TO HELP SUPPORT WEAKER CURRENCIES, IT WOULD MAKE IT LESS ATTRACTIVE AS AN ALTERNATIVE TO DOLLARS THEREBY REDUCING SPECULATIVE DEMAND AGAINST THE U.S. ON THE OTHER HAND, IF THE MARKET ACCEPTED THE NEW EXCHANGE RELATIONSHIPS WITHIN EMS AS SOLID, IT COULD INCREASE THE NUMBER OF MARKETS REGARDED AS ALTERNATIVES TO DOLLAR INVESTMENTS AND HAVE A DEPRESSING EFFECT ON THE DOLLAR.

13. AS TO WHAT POLICY THE EMS MIGHT FOLLOW VIS-A-VIS THE DOLLAR, HE HAD NO IDEA BUT SPECULATED IT MIGHT BE EASIER FOR US TO DEAL WITH ONE RATHER THAN MANY AUTHORITIES.
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COMMENT: BAQUIAST HAS A REPUTATION FOR BEING FRANK AND FRIENDLY. HIS REMARKS CONFIRM EARLIER IMPRESSIONS THAT: (A) THE FRENCH AND GERMANS ARE FORCING THE PACE WITH THEIR PROJECT; (B) A GREAT DEAL OF WORK REMAINS TO BE DONE TO MAKE IT PRACTICAL, AND (C) THE FRENCH ARE REASONABLY CONFIDENT THAT THERE IS ENOUGH FLEXIBILITY AND CREDIT BUILT INTO THE SYSTEM TO ENABLE THEM TO REAMIN IN IT FOR SOME TIME. WHILE HE WAS OBVIOUSLY PLAYING DOWN POTENTIAL DIFFICULTIES FOR THE DOLLAR, HIS REMARKS IN PARA 13 SUGGEST THE POSSIBILITY OF MORE "COORDINATION" THAN WE MIGHT DESIRE.
HARTMAN

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